W. Scott Randolph
Director – Regulatory Affairs

Verizon Communications
1300 I Street
Suite 500E
Washington, DC 20005

Phone: 202 515-2530
Fax: 202 336-7922
srandolph@verizon.com

August 29, 2002

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, DC 20554

Ex Parte: **Federal-State Joint Board on Universal Service, CC Docket No. 96-45; 1998 Biennial Regulatory Review – Streamlined Contributor Reporting Requirements, CC Docket No. 98-171; Telecommunications Services for Individuals with Hearing and Speech Disabilities and the Americans with Disabilities Act of 1990, CC Docket No. 90-571; Administration of the North American Numbering Plan and North American Numbering Plan Cost Recovery Contribution Factor and Fund Size, CC Docket No. 92-237, NSD File No. L-00-72; Numbering Resource Optimization, CC Docket No. 99-200; and Telephone Number Portability, CC Docket No. 95-116**

Dear Ms. Dortch:

On August 28, 2002, Ann Rakestraw, Ed Shakin and the undersigned, met with John Rogovin and Debra Weiner of the Office of General Counsel to discuss proposals to revise the methodology for contributing to the universal service funds. We explained how the per-connection proposal advocated by the Coalition for Sustainable Universal Service (CoSUS) would violate Section 254(d) of the Act because it would not have "every" carrier "contribute on an equitable and nondiscriminatory basis" to support universal service. The CoSUS proposal is also contrary to the decision reached in *Texas Office of PUC v. FCC*, 183 F.3d 393 (5th Cir. 1999), because it requires the majority of support to come from intrastate services and would remove any obligation of providers of interstate long distance services to contribute. Further, we noted that the record in this proceeding lacks sufficient evidence to support a move to a per-connection assessment, including the absence of data and other information to adequately assess future impacts on consumers, especially multi-line business customers.

We also discussed how the recommendation of the State Members of the Universal Service Joint Board poses additional legal problems in that it would result in the creation of implicit subsidies in violation of Section 254(e) and discriminatory treatment in violation of Section 202(a).

The attached material was used in the discussions.

Pursuant to Section 1.1206(a)(1) of the Commission's rules, and original and one copy of this letter are being submitted to the Office of the Secretary. Please associate this notification with the record in the proceedings indicated above. If you have any questions regarding this matter, please call me at (202) 515-2530.

Sincerely,

W. Scott Randolph

Attachment

cc: John Rogovin
Debra Weiner
Linda Kinney

Universal Service Contribution Mechanism

Legality Concerns With the Proposals by COSUS and the State Joint Board Members

August 2002

The Per-Connection Proposal Endorsed by COSUS Is Unlawful for Several Reasons

- The Fifth Circuit has specifically found that, in implementing the current, revenue-based system, the Commission "reasonably applied the principle of equitable and nondiscriminatory contribution by requiring contributions from *all* telecommunications providers." *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 623 (5th Cir. 2000) (emphasis added).
- The COSUS proposal violates 47 U.S.C. § 254(d) because it does not have "every" carrier "contribute on an equitable and nondiscriminatory basis."
  - Applying a discriminatory formula in a neutral fashion is not "equitable and nondiscriminatory" treatment.
  - Just because some of the large long distance carriers will still contribute *something* to universal service program does not mean that they will contribute on an "equitable and nondiscriminatory basis."
  - While COSUS argues that its proposal is "competitively neutral," even if true, that is a necessary, not sufficient, requirement for meeting the "equitable and nondiscriminatory" test.

The Per-Connection Proposal Endorsed by COSUS Is Unlawful for Several Reasons (cont'd)

- In *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 434 (5th Cir. 1999), the court noted that § 254(d)'s equitable and nondiscriminatory requirement "also refers to the fairness in the allocation of contribution duties." Here, those duties would be disproportionately borne largely by local, wireless, and paging carriers – and not by long distance or other carriers.

- The COSUS proposal also violates § 254(d) because a carrier may only be exempt from contribution if its "*activities* are limited to such an extent" that its contribution would be de minimis.
  - The Commission cannot set a discriminatory formula that would simply *result* in certain carriers' "assessment" becoming de minimis.
  - COSUS admits that "there are likely some telecommunications carriers that provide interstate telecommunications, including standalone dial-around carriers and standalone long distance resellers, that would not be required to make a contribution under the CoSUS formula." Letter from John Nakahata, COSUS, to Marlene Dortch, FCC, at 4 (filed 8/22/2002).

The Per-Connection Proposal Endorsed by COSUS Is Unlawful for Several Reasons (cont'd)

- The COSUS proposal violates *Texas Office of PUC v. FCC*, 183 F.3d 393 (5th Cir. 1999), because it requires the majority of support to come from intrastate, rather than interstate, services. Per-connection increases support required by intrastate providers and removes obligations from providers of interstate long distance services. By using a method that relies upon intrastate services and their revenues, it "easily constitutes a 'charge . . . in connection with intrastate commerce,'" in violation of § 2(b). 183 F.3d at 447.
- The record "lacks substantial evidence" to support a move to *any* per-connection proposal at this time. *See generally AT&T Corp. v. FCC,* 86 F.3d 242, 247 (D.C.Cir.1996). On the current record, there is not "substantial evidence" – or, indeed any real data – regarding the future impact a per-connection approach would have on customers, especially multi-line business customers.

The Recommendation of the State Members of the Joint Board Poses Additional Legal Problems

- The recommendation of state Joint Board members, to freeze universal service charges to residential end users and impose all future increases on multi-line business customers for the next five years, and to prohibit carriers from recovering administrative costs, presents additional legal problems.
- Imposing future USF increases only on multi-line business customers violates the Act because:
  - It creates an implicit subsidy, by placing all future increases in universal service charges on multi-line business customers, contrary to the Act's requirement that universal service support be "explicit and sufficient." 47 U.S.C. § 254(e). The Commission receives no *Chevron* step-two deference on this issue, because "the plain language of §254(e) does not permit the FCC to maintain *any* implicit subsidies for universal service support." *Texas Office of PUC*, 183 F.3d at 425.

The Recommendation of the State Members of the Joint Board Poses Additional Legal Problems (cont'd)

  - It is not "specific, predictable, and sufficient." *See* 47 U.S.C. §254(d) With the current record, it is impossible to predict the initial impact on multi-line businesses, much less the future impact.
  - It arguably requires carriers to make "discriminatory" preferences, in violation of 47 U.S.C. § 202(a).
- Failing to let carriers pass on administrative costs will lead to implicit subsidies, contrary to the Act's directive that universal service support "should be explicit and sufficient to achieve the purpose of this section." 47 U.S.C. § 254(e). Without allowing carriers to recover these administrative costs, the contribution method is neither "explicit" nor "sufficient."

Conclusion

- More than 25 commenters questioned the lawfulness of the COSUS proposal. It is sure to face legal challenges if adopted.
- The ex parte recommendation by the state members of the Joint Board only adds to the legal problems of the COSUS proposal.
- There is not a sufficient record to move to *any* per connection method at this time, because there does not yet exist "sufficient evidence" regarding the costs and benefits of such a system.

How would the collect and remit proposal work?

Current process	Verizon's proposal
1. On Form 499, all providers of interstate telecommunications services report their gross billed interstate revenues for each quarter. The amount billed to recover contributions is reported on an annual basis.	1. Form 499 would be revised to require interstate telecommunications service providers to report net interstate revenues actually received from customers (not including the amount that recovers the providers' contributions to the federal universal service fund), rather than gross billed interstate revenues.
2. The Universal Service Administrative Company (USAC) projects the funding need for the next quarter of the year.	2. Each quarter, all providers of interstate telecommunications services would report the net amount of interstate revenues received from their customers (not including the amount that recovers the providers' contributions to the federal universal service fund) during the previous quarter on the revised Form 499.
3. The FCC establishes the contribution factor for the next quarter by dividing the projected funding need by the total industry interstate revenues from the past quarter of the year (including a 1% carrier uncollectible adjustment). The current factor is 7.28%.	3. USAC would project the funding need for the next quarter of the year.
4. This results in a contribution factor that is assessed on a six-month time lag. For example, the gross billed interstate revenues for the first quarter of the year are reported in the second quarter. The anticipated funding need for the third quarter is also developed during the second quarter. A contribution factor for the third quarter is calculated by dividing the projected funding need by the total industry interstate revenues from the first quarter. This contribution factor is used by firms to develop a charge that is billed in the third quarter.	4. USAC would incorporate both carrier and end user uncollectible factors, and would project total industry interstate revenues that would actually be received by contributing telecommunications firms for the next quarter. This projection would use statistical methods similar to those successfully used by the FCC staff and by NECA. This projection would be reasonably accurate at the start, and would become more so as additional data points become available and more experience is gained.
5. Contributing firms develop their next quarterly contribution charge assessed upon their customers by considering: whether their revenues are increasing or decreasing; their uncollectibles; administrative expenses associated with billing, collecting and remitting monies to the administrator; and other factors (*e.g.*, their projection of billable units during the next quarter).	5. The FCC would develop the contribution factor for the next quarter by dividing the projected funding need by projected total industry interstate revenues to be collected from consumers.
6. In some cases, these adjustments have resulted in billing an amount that is substantially different than the contribution factor published by the FCC.	6. Firms would develop their charge to customers based upon the contribution factor. This charge could be developed as either the published contribution percentage times the monthly interstate charge on the individual bill, or as a flat monthly amount reasonably reflecting the average interstate charges for a class of customers, such as single line residential and business customers. (Verizon uses the latter approach because it is more stable and predictable for consumers, and costs less.)
	7. As today, contributing firms would be able to mark up the contribution factor by a small amount to reflect administrative expenses solely related to billing, collecting and remitting to the fund administrator. This administrative markup should be limited to a "safe harbor" amount (typically 1% to 3% in state programs). The FCC would develop the administrative "safe harbor" level and could require contributing firms to justify any administrative mark up above the "safe harbor" level. ▪ Because the contribution factor already reflects net revenues, there is no need for an uncollectible markup.
	8. Firms that add a contribution charge to their bills would label it to alert consumers that it represents recovery of contributions to the federal universal service program. Typical line item labels would include: "Federal Universal Service Contribution," "Federal Universal Service Fee," or "Universal Connectivity Fee."
	9. Contributing firms would remit to the fund administrator an amount equal to the contribution percentage times their actual interstate revenues for a quarter (not including the amount that recovers the firm's contributions to the federal fund). This means a firm could choose to not charge a customer for competitive or other reasons, but would still have an obligation to provide contribution for that customer's interstate revenue amount. ▪ Because the administrative safe harbor amount would be the only mark up permitted, firms would not be able to make up from some customers amounts not charged to other customers. ▪ Because contributions for each firm are based on their current revenues, there is no need for contributors to adjust their charges to customers for declining or increasing revenues.